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Housing Finance & Regulatory Affairs

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Office of the Comptroller of the
Currency
Legislative and Regulatory Activities
Division
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC–2013–0016
RIN 1557 AD 74
Email:
regs.comments@occ.treas.gov

Board of Governors of the
Federal Reserve System
20th Street & Constitution Ave, NW
Washington, DC 20551
Attn: Robert deV. Frierson, Secretary
Federal Reserve Docket No. R–1466
RIN 7100 AE-03
Email:
regs.comments@federalreserve.gov

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: Robert E. Feldman, Executive
Secretary
FDIC: RIN 3064–AE04
Email: comments@FDIC.gov

RE: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Dear Sir/Madam,

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to submit comments on the above-referenced Notice of Proposed Rulemaking (proposed rule) that would implement a liquidity coverage ratio standard for U.S. banking organizations meeting specific parameters. NAHB is a Washington-based trade association representing more than 140,000 members involved in all aspects of single-family and multifamily residential construction. NAHB and its members have a strong interest in establishing and sustaining a housing finance system that offers home buyers access to affordable mortgage financing in all geographic areas, in all economic conditions.

Background

As became evident during the recent financial crisis, the importance of large banking organizations having ready access to liquid assets in times of economic turmoil should not be underestimated. The financial system's vulnerability was painfully exposed as many banking organizations world-wide struggled to access sufficient liquidity to meet obligations during the financial meltdown. Following the crisis, the international banking community met to establish international liquidity standards intended to improve the system's ability to absorb unexpected and significant stress. Jointly, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Deposit Insurance Corporation (collectively, the federal banking agencies) and banking regulators from foreign jurisdictions developed the "Principles for Sound Liquidity Management and Supervision" in 2008.

Currently, there is no liquidity standard requirement imposed on U.S. banking organizations. Rather, liquidity risk policy at U.S. banking organizations is guided by a statement issued by the federal banking agencies, the National Credit Union Administration and the Conference of State Bank Supervisors in March 2010 titled the "Interagency Policy Statement on Funding and Liquidity Risk Management." The statement lays out supervisory expectations for liquidity risk management practices at U.S. banking organizations including comprehensive management processes for identifying, measuring, monitoring, and controlling liquidity risk. Additionally, the statement strengthens the rather general processes in place prior to the financial crisis when the individual supervisory agencies evaluated the liquidity risk management practices of individual banking organizations under their purview on a case-by-case basis.

In December 2010, the Basel Committee on Banking Supervision (BCBS) established quantitative standards for liquidity in the "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring" (Basel III Liquidity Framework), which introduced a liquidity coverage ratio (LCR) and a net stable funding ratio as well as a set of liquidity monitoring tools. When released, the Basel III Liquidity Framework caused concern at some U.S. institutions that feared the federal banking regulators would issue regulatory rulemaking for U.S. banking organizations based on the framework.

Rulemaking in the U.S. on the December 2010 Basel III Liquidity Framework did not happen and the framework was revised by the BCBS in January 2013 as "Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools" (Basel III LCR) The proposed rule issued jointly by the federal banking agencies would implement the BCBS' January 2013 liquidity framework in the U.S. for large internationally active banking organizations, nonbank financial companies designated by the Financial Stability Council for Federal Reserve Board supervision that do not have substantial insurance activities (covered nonbank companies) and their consolidated subsidiary depository institutions with total assets greater than $10 billion.

In 2012, pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the Federal Reserve proposed enhanced liquidity standards for large U.S. banking organizations, certain foreign banking organizations, and nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve.

Proposed Rule

The proposed rule establishes a minimum LCR for designated U.S. banking organizations that is consistent with the January 2013 Basel III LCR. The overarching intent of the proposal is to ensure banks are holding enough high-quality, liquid assets (HQLA) to meet requests for customer withdrawals and other cash requirements (outlays) for up to 30 days in the event of a credit crisis. The proposal includes recommendations for defining high-quality liquid assets, calculating the inflow and outflow rates of liquid assets, and phasing-in the LCR requirement in the U.S.

The proposed rule would apply to all internationally active banking organizations with $250 billion or more in total assets or $10 billion or more in on-balance sheet foreign exposure, and to consolidated subsidiary depository institutions of internationally active banking organizations with $10 billion or more in total consolidated assets. The Federal Reserve is proposing to implement a modified version of the LCR for bank holding companies and savings and loan holding companies without significant insurance or commercial operations that, in each case, have $50 billion or more in total consolidated assets, but are not covered companies for the purposes of the proposed rule. Covered banking organizations would need to be compliant up to 80 percent of the ratio by January 1, 2015; 90 percent of the ratio by January 1, 2016; and be fully compliant with the LCR by January 1, 2017.

Community banks are not covered by the proposed rule and consequently will not be required to hold a specific percentage of HQLA.

The LCR is the ratio of a bank's HQLA, as defined in the proposed regulation, divided by its projected net cash outflow. The proposed rule would require a covered company to maintain a LCR of 100 percent, i.e. the amount of high-quality liquid assets must equal no less than 100 percent of its expected total net cash outflows over a prospective 30-calendar day period. The Federal Reserve would apply the same approach to smaller banks, but they would have to hold HQLA to cover net cash outflows over a prospective 21-calendar day period of liquidity stress.

The Basel III LCR standard requires HQLA to be unencumbered by liens and other restrictions on transferability and must be convertible into cash easily and immediately in deep, active private markets. LCR has three categories of assets that may be counted toward a bank's HQLA: Level 1, Level 2A, and Level 2B. Most of the assets in these categories would need to meet the proposed rule's definition of "liquid and readily-marketable" in order to be included in HQLA. With respect to a security, liquid and readily-marketable means the security is traded in an active secondary market with: (1) more than two committed market makers; (2) a large number of non-market maker participants on both the buying and selling sides of transactions; (3) timely and observable market prices; and (4) a high trading volume.

Level 1 liquid assets are the highest quality and most liquid assets and include: (1) Federal Reserve Bank balances; (2) withdrawable reserves held at a foreign central bank; (3) securities issued or unconditionally guaranteed as to the timely payment of principal and interest by the U.S. Department of Treasury; (4) liquid and readily-marketable securities issued or unconditionally guaranteed as to the timely payment of principal and interest by any other U.S. government agency (provided that its obligations are fully and explicitly guaranteed by the full faith and credit of the U.S.; (5) certain liquid and readily marketable securities that are claims on, or claims guaranteed by, a sovereign entity, a central bank, and other international entities that are assigned a 0 percent risk weight under the standardized approach of the revised regulatory capital rules.

Level 1 liquid assets may be included in the HQLA amount without limit due to their consistently highly liquid nature.

Level 2A liquid assets include claims on, or claims guaranteed by, a U.S. government sponsored enterprise (GSE) and claims on, or claims guaranteed by, a sovereign entity or a multilateral development bank that are assigned a 20 percent risk weight under the standardized approach of the revised regulatory capital rules. Assets would be required to be readily-marketable.

Level 2A liquid assets generally demonstrate a high level of liquidity, but due to their characteristics, may be at higher risk for "liquidity impediments" than Level 1 liquid assets.

To reflect the possibility of liquidity impediments, Level 2A liquid assets would be subject to a 15 percent haircut under the proposal and may only comprise 40 percent of total HQLA when combined with level 2B liquid assets.

Level 2B liquid assets include certain publicly-traded corporate debt securities; and publicly-traded shares of common stock that are liquid and readily-marketable. In addition to meeting the liquid and readily-marketable test, these publicly-traded securities and stock would be required to meet other specific requirements that the federal banking agencies believe indicate liquidity.

Level 2B liquid assets are subject to significantly higher risk of loss of liquidity due to idiosyncratic or market-wide factors and would, therefore, be subject to a 50 percent haircut and could only comprise 15 percent of total HQLA.

NAHB Comments

A reliable, stable, and efficient banking system is critical to home builders and developers who depend on the banking system to provide financing for acquisition, development and construction projects as well as to provide mortgage credit to consumers buying new homes. While many of NAHB's members obtain financing directly from their community banks that will not be subject to the LCR requirement, there are components of the proposed requirement that NAHB believes will impact the entire banking system and subsequently affect consumers.

The importance of liquidity to the banking system is well-understood and acknowledged. The recent financial crisis underscored how quickly substantial levels of liquidity in the banking system could evaporate. U.S. banks with loosely regulated liquidity risk management practices experienced a liquidity crisis that rippled through the banking system, financial markets, and the economy at large with an enormous and long-lasting impact. NAHB recognizes that the federal banking agencies seek to establish appropriate levels of liquidity at the largest banking organizations in the best interest of the financial system as a whole with the intent to prevent, or at least mitigate, a crisis of this nature from happening in the future. NAHB's comments will be limited to two areas of the proposed requirement that we believe may have unintended consequences for the housing finance system, home builders and home buyers.

Treatment of GSE Securities

NAHB is concerned that the treatment of Fannie Mae and Freddie Mac mortgage-backed securities (GSE securities) under the proposed LCR will have a negative impact on the liquidity of the securities and subsequently increase interest rates on conventional, conforming mortgage loans. NAHB believes that categorizing GSE securities as Level 2A liquid assets will discourage the largest U.S. banks from purchasing GSE securities. Due to the 15 percent haircut and 40 percent limit toward a banking institution's HQLA, Level 2A liquid assets are not as valuable to large banks when calculating their LCR as U.S. Treasury securities, Ginnie Mae securities or other Level 1 liquid assets. If big banks cut back on their purchases of GSE securities, the excess supply will push down prices of these securities resulting in a rise in yields on the securities and, ultimately, an increase in interest rates on the underlying mortgage loans.

U.S. depositories held just under 25 percent of outstanding agency and GSE securities in the third quarter of 2013. This has been a fairly stable percentage since 2009. Although, this includes other government-backed mortgage securities in addition to GSE securities, it demonstrates U.S. depositories currently are significant buyers of GSE securities.

In conjunction with the prospect that big banks would reduce their purchases of GSE securities, NAHB believes the federal banking agencies should consider the potential impact on GSE securities of the Federal Reserve's recent tapering of its quantitative easing program. Since September 2012, the Federal Reserve has been purchasing $85 billion per month of Treasury securities and agency mortgage-backed securities (MBS) to encourage lower interest rates and economic expansion. Beginning in January 2014, the Federal Reserve will reduce its purchases of securities from $85 billion per month to $75 billon, with the reduction evenly split between Treasury securities and agency MBS. The Federal Reserve will purchase $40 billion of Treasury securities each month (down from $45 billion) and $35 billion of agency securities (down from $40 billion) each month.

NAHB believes the disincentive for big banks to purchase GSE securities, indeed maybe an incentive to sell a portion of their current holdings as a result of the LCR rule, combined with the reduction in purchases of agency securities by the Federal Reserve, will cause the value of GSE securities to fall. Although the big banks will not be required to meet the LCR ratio until January 2015, it is likely they will begin to work toward meeting the ratio sooner than next January and begin cutting back on their MBS holdings. With the recovery of the housing industry still in a tenuous state, introducing any disruption or uncertainty to the MBS markets at this time could stifle further improvement.

NAHB Recommendations

NAHB understands the federal banking agencies do not believe GSE securities are as liquid as U.S. Treasury securities or Ginnie Mae securities. Further, the federal banking agencies state that the GSEs remain privately-owned companies and their obligations do not carry the explicit guarantee of the full faith and credit of the U.S. In fact, the LCR proposal reflects the difference in how these securities are treated in the Basel III regulatory capital rules. Under the risk-based capital regime of Basel III, Ginnie Mae securities have a risk-weighting of 0 percent and securities guaranteed by Fannie Mae and Freddie Mac have a risk-weighting of 20 percent.

However, NAHB believes that while the GSEs are in conservatorship, their securities do meet the definition of Level 1 liquid assets to a degree that should allow them to qualify as Level 1 liquid assets when a bank calculates its LCR. There is no question they meet the federal banking agencies' definition of liquid and readily marketable securities and it is assumed by the broad marketplace that they are guaranteed as to the timely payment of principal and interest by the U.S. government.

NAHB recommends that GSE securities should be classified at Level 1 liquid assets. At the very least, the agencies should reduce the 15 percent haircut and increase the limitation on the allowance of GSE securities toward LCR above 40 percent in the Level 2A liquid assets category. The 15 percent haircut and the 40 percent limitation are very restrictive for the significant liquidity GSE securities currently provide. If the federal banking agencies determine to maintain the proposed haircut and cap on GSE securities, NAHB believes the agencies should detail the specific rationale for the 15 percent haircut and 40 percent limitation to demonstrate that these are not arbitrary numbers and that they are based on a considered analysis.

<u>Treatment of Private Label MBS</u>

NAHB also is concerned that private label MBS are not counted at all in calculating a banking organization's LCR. NAHB is a strong proponent of housing finance system reform and we believe reform should ensure a multifaceted mortgage market with both private and government sources of mortgage credit. This approach encourages competitive pricing as well as increased credit availability for borrowers who may not meet the credit requirements of the GSEs, the Federal Housing Administration (FHA), the Veteran's Administration (VA) and other government insurance programs whose loans collateralize Ginnie Mae securities. Today, the GSEs and Ginnie Mae continue to securitize and guarantee close to 90 percent of the MBS issued while the private label MBS market continues to sit on the sidelines citing the competitive price advantage of the government guaranteed market as one reason for its lack of participation.

There has been much discussion among housing industry and mortgage finance market participants, including NAHB, about how to encourage private capital to reenter the mortgage market. NAHB believes if the biggest U.S. banks could count a certain level of private label MBS toward their LCR ratio, the private label MBS market might see increased opportunity for participation. Leaving private label MBS out of all levels of qualifying HQLA eliminates a potential incentive for the biggest U.S. banks to purchase private label MBS and may further discourage the reemergence of a robust private label MBS market.

NAHB Recommendation

NAHB recommends that the federal banking agencies reconsider the liquidity potential of private label MBS and allow these securities to receive some level of value as HQLA. The possibility that this action could accelerate a return of the private market to the MBS arena and begin to bring heightened liquidity to that market should not be discounted.

Conclusion

NAHB believes classifying GSE securities as Level 2A liquid assets for purposes of calculating a bank's LCR would disrupt demand for these securities in the market. While the exact impact is impossible to determine, now is not the time to introduce more uncertainty into the mortgage market. The housing finance industry and MBS market remain in a state of vulnerability. In addition, NAHB recommends that the federal banking agencies allow private label MBS to receive some level of value as HOLA. We encourage the federal banking agencies to place an emphasis on supporting the housing recovery and MBS market rather that creating disincentives to participate.

Thank you for the opportunity to submit comments on this important NPR. If you have any questions, please feel free to contact Rebecca Froass, Director, Financial Institutions and Capital Markets, at 202-266-8529 or rfroass@nahb.org.

Sincerely,

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David L. Ledford
Senior Vice President
Housing Finance & Regulatory Affairs